No. 20645

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

THE INTERPUBLIC GROUP OF COMPANIES, INC., a corporation, McCANN-ERICKSON, INC., a corporation, and INTERPUBLIC INC., a corporation,

Appellants,

vs.

ON MARK ENGINEERING CO., a corporation, and SECURITY FIRST NATIONAL BANK,

Appellees.

BRIEF OF APPELLEES.

On Mark Engineering Co., a Corporation, and Security First National Bank.

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STATEMENT OF THE CASE.

Appellees believe that it will be helpful to the Court to have before it at the outset a more complete statement of the facts which are relevant to the points raised on appeal than is set forth in the opening brief of appellants. Accordingly, we submit our own statement of the case at this point.

A. Negotiations and Circumstances Leading to the Lease and Option Agreement.

Commencing some time in early 1959, representatives of appellee On Mark Engineering Co. (hereinafter called "On Mark") and appellants (hereinafter called "Inter-

with Interpublic's specifications for $385,000. After setting forth the $385,000 figure, the telegram stated: *"Will furnish very attractive lease with option to purchase to cover five (5) year period."* [Pltf. Ex. 1] (Emphasis added)

After receipt of the telegram, Harder came to Los Angeles in July, 1959, and met again with Denny. Harder's instructions from Harper were to finalize the specifications and determine the cash outlay or lease price of the proposed aircraft so that Interpublic would know what the commuted value per month on a lease would be. [Rep. Tr. pp. 923, 924]

The meeting between Denny and Harder resulted in improving the specifications substantially from Interpublic's standpoint by substituting a new Collins automatic pilot instead of a Sperry A-12 automatic pilot, and making other changes, but still within the overall price of $385,000. [Rep. Tr. pp. 920-921]

Harder requested of Denny that On Mark give Interpublic a quotation on a sixty-month lease. [Rep. Tr. p. 233]

On Mark was in the business of manufacturing and selling, not leasing, planes. To determine the monthly rental over a sixty-month period for an aircraft having a cash or cost price of $385,000, On Mark contacted the United States Leasing Company in San Francisco and asked for the correct formula to be applied on a lease-option basis. [Rep. Tr. pp. 250-251]

The leasing company advised On Mark that a good "rule of thumb" for determining the rental was 2¼% of the cash or lease price per month, with the first two and the last three months' rental paid in advance;

and that the "option price" should be figured at between 8% and 10% of the original value of the plane. [Rep. Tr. pp. 250, 251]

On Mark's secretary and treasurer prepared an amortization schedule using the formula furnished by the United States Leasing Company and confirmed the fact that under the lease-option arrangement, along these lines, On Mark would be as well off financially as with an outright sale at a price of $385,000. [Rep. Tr. p. 271]

Denny discussed the matter with Harder, told him that the monthly rental on a sixty-month lease would be $7,747.00 per month and that On Mark *"would give [Interpublic] an option purchase price at the end of the lease when the sixty-month rentals had been paid, for $32,950."* [Rep. Tr. p. 272] (Emphasis added)

Harder replied that this seemed reasonable and satisfactory and he would recommend that it be approved by Interpublic. [Rep. Tr. p. 273]

Harder reported the proposed terms of the lease and option agreement to Harper, President of Interpublic. Harper testified that he had no idea of how the "option price" of $32,950 was determined. He made a computation of what the total payments by Interpublic would be for the lease rentals and the option to purchase the aircraft and arrived at a figure of "something like $460,000 or $470,000 plus the amount of the recovery of the aircraft, bringing the total to approximately a half million dollars." [Rep. Tr. p. 1416].

On Mark's attorneys prepared separately the lease and the option agreement because Interpublic "wanted them in two separate documents." [Rep. Tr. p. 397]

1959, and the term of the lease commenced at that time. [Find. 10, Clk. Tr. p. 164]

On Mark spent approximately $385,000 in remanufacturing the A-26 aircraft to Interpublic's specifications. [Rep. Tr. p. 264] To finance these costs, On Mark borrowed $375,000 from appellee Security First National Bank pursuant to a promissory note which provided for payment of $7,747.00 per month. [SFB Ex. 1] Denny and one of On Mark's other stockholders, Mr. Doheny, personally guaranteed on Mark's note to the bank. [Rep. Tr. p. 379] To secure payments of the note, the bank took a chattel mortgage on the A-26 aircraft and an assignment of rentals due On Mark under its lease with Interpublic. [SFB Ex. 2, 3]

On February 25, 1960, after the A-26 aircraft was in the possession of the lessee, Interpublic gave its written consent to the assignment of the rents due under the lease from On Mark to the Security First National Bank to secure On Mark's $375,000 loan from the bank. Said consent stated by its terms that so long as On Mark remained indebted to the bank, the lease would not be terminated by Interpublic without the written consent of the bank. [Pltf. Ex. 9]

C. Accident to the Plane and Interpublic's Conduct and Action Thereafter.

Interpublic had continuous possession of, and operated, the A-26 aircraft from the time of its delivery in December, 1959 until June 28, 1962. During this period Interpublic maintained and repaired the plane as needed, paid all of its operating expenses, and in other ways treated the plane as its own. The lessees, as required by the lease, provided and paid for insurance on

the aircraft. The performance of the aircraft was completely satisfactory while it was being operated by Interpublic. [Find. 11, Clk. Tr. p. 164]

On June 28, 1962, while being operated by Interpublic, the A-26 aircraft was damaged in an accident at Elkhart, Indiana. The accident occured while the plane was taxiing at a speed of approximately five miles per hour over a newly paved macadam ramp containing a reinforced concrete dry well at the Elkhart Airport. The roof of the dry well collapsed, the right main landing gear of the A-26 aircraft descended into the resulting hole, and the plane came to rest supported by the tail of the fuselage, right hand wing tip, propeller blade and other portions of the plane. [Find. 12, Clk. Tr. pp. 164-165]

Following the accident a decision had to be made concerning the extent of the damage to the plane and whether it was capable of economic repair. Almost immediately, as the trial court found, Interpublic secretly decided that it would not again take possession of or operate the A-26 aircraft no matter whether or not it was fully repaired, and determined to secure another plane for its permanent use in place of the A-26 aircraft. To this end, Interpublic sought to induce On Mark to declare the A-26 aircraft a "total construtive loss," in order to cause a termination of the lease. [Find. 14; Clk. Tr. pp. 165-166] On Mark, however, after a careful inspection of the damage to the aircraft notified Interpublic that it was repairable, and that it proposed to make the necessary repairs. [Finds. 13, 18, 19; Clk. Tr. pp. 165-168; Pltf. Exs. 32, 47]

On August 8, 1962, On Mark advised Interpublic in writing that because of the accident "it is understood

that your obligation to pay the monthly rental under the lease is temporarily suspended *and the term of the lease agreement is extended accordingly.*" [Pltf. Ex. 32] (Emphasis added)

On September 21, 1962, On Mark wrote Interpublic that it was estimated that it would take approximately seventy days from the commencement of the work to complete the repairs, and that On Mark exercised its option under the lease to repair the plane *"and to extend the term of the lease accordingly."* [Pltf. Ex. 47] (Emphasis added)

During the period from the date of the accident to completion of repairs, Interpublic never advised On Mark that Interpublic did not intend to retake possession of the A-26 aircraft but, rather, it intentionally led On Mark to believe that after repair Interpublic would accept redelivery of the plane. Nor during this time did Interpublic voice any objection to On Mark's determination that the lease term had been extended by a period commensurate with the time required to repair the plane. Instead, Interpublic immediately leased on a temporary basis a replacement aircraft at a rental less than that which it had paid to On Mark, and attempted to find a permanent replacement for the A-26 aircraft. Harper sent Harder to Europe where a suitable plane was found and purchased by Interpublic in October, 1962, flown to the United States, then resold by Interpublic to a leasing corporation, which in turn leased the plane back to Interpublic. [Finds. 17, 20, 26]

After making other unsuccessful attempts to find a means to terminate its liability under the lease, Interpublic received On Mark's letter of February 14, 1963, stating that the repairs would soon be completed and the plane would be ready for delivery. [Find. 17, Pltf. Ex. 70] Interpublic waited until February 20, 1963, and then advised On Mark for the first time that it would not accept delivery of the plane because, it was claimed, the repairs had not been made "promptly" and the lease had been "terminated." [Pltf. Ex. 72]

On Mark immediately denied Interpublic's claim, advised again that the plane was ready for delivery, and asked Interpublic to reconsider its position. [Pltf. Ex. 74]

Later, after the present action was filed, Interpublic also contended that On Mark had not "properly" repaired the aircraft.

The trial court found, and appellants do not challenge such finding, that the A-26 aircraft had been "promptly" and "properly" repaired, and that Interpublic had breached the lease by refusing to accept redelivery of the plane and to pay the rentals due to On Mark. [Finds. 23, 24; Concl. of Law 9; Clk. Tr. pp. 169, 170, 174-175]

D. Interpublic's Purported Exercise of the Option to Purchase the Plane.

More than twenty-four months after making any payment of rent to On Mark, and more than sixteen months after purportedly terminating the lease, Interpublic on June 30, 1964, wrote to On Mark and advised that Interpublic intended to "exercise the option" to purchase the A-26 aircraft on July 15, 1964. [Find. 30; Clk. Tr. p. 171]

On Mark advised Interpublic that the lease and option agreement constituted a single agreement, that Interpublic was then in default under the lease-option agreement and then owed On Mark more than $147,952 in rentals and other expenses, plus interest charges thereon. Accordingly, On Mark denied that Interpublic had any right whatsoever to exercise the option to purchase the aircraft. [Cl. Tr. p. 130, paragraph 9]

On Mark maintained a consistent position throughout the trial, that Interpublic was not entitled to so exercise the option since it was then in default under the lease. On Mark also contended, and the trial court found, that even if Interpublic had not been in default, the time for exercise of the option was extended, first, by the original delay in commencement of the lease (from October to December 18, 1959) and, secondly, by the extension of the lease during the repair period after the accident (June 28, 1962 to February 20, 1963), that is, until January 26, 1965; and that a condition precedent to the exercise of the option was the payment to On Mark of sixty monthly rentals aggregating $464,820. [Find. 30; Clk. Tr. 171]

SUMMARY OF ARGUMENT.

Appellants' sole ground for their appeal centers about the "option" to purchase the aircraft contained in the lease-option agreement. Appellants do not challenge the trial court's determination that Interpublic had intentionally breached the agreement by refusing to accept redelivery of the aircraft and by failing to pay any of the monthly rentals due after February, 1963, or that at the very time it purported to exercise the option on June 30, 1964, Interpublic owed $123,952.00 for rent on the aircraft which it has never tendered or offered to pay.

Appellants' claim on this appeal really gets down to this: notwithstanding Interpublic's admitted breaches and defaults of the lease-option agreement which had continued for some sixteen months, and the fact that the term of the lease had been extended to a date far beyond its original term, Interpublic had the *absolute right*, in July, 1964, to exercise the option to purchase an aircraft costing at least $385,000 for $32,950.

Appellees submit that appellants' claim is preposterous and should be rejected on this appeal because: (1) there was an inconsistency, ambiguity and an uncertainty in various provisions of the lease-option agreement which required extrinsic evidence to aid in the contract's interpretation; (2) Interpublic had no right to exercise the option when it was then in default of the agreement and had claimed for a long time that the contract had been terminated; (3) Interpublic was not entitled to exercise the option until it had paid sixty months' rent; and (4) the term of the lease, and the date for exercise of the option, had been extended to a date far beyond July, 1964.

Concerning appellants' alleged "Specifications of Errors" (App. Op. Br. p. 10), all of which spring from the basic determination discussed immediately above, appellees maintain that:

1. The District Court properly permitted evidence concerning the negotiations and surrounding circumstances of the execution of the lease-option agreement in order to explain a basic ambiguity, uncertainty, and inconsistency in the two documents comprising the agreement.

2. The trial court properly determined that the option to purchase the aircraft was not exercisable between July 15, 1964 and August 15, 1964, and such a determination is clearly supported by the record.

3. Lease rentals and maintenance and other costs incurred after the period July 15 to August 15, 1964 were clearly the responsibility of Interpublic, for the term of the lease was extended to a date long after August 15, 1964.

4. The District Court correctly refused to offset the "value of the option" against On Mark's right to recover rent, for Interpublic had no right to exercise the option when it was in default, the option agreement did not authorize such an "offset" and, in any event, Interpublic could not exercise the option until it had paid sixty monthly rentals to On Mark.

5. The District Court correctly determined that Security First National Bank was entitled to $118,857.10, with interest, of the $201,422.00 accrued rent due to On Mark.

ARGUMENT.

I.

The Trial Court Properly Received Evidence Concerning Negotiations and Circumstances Surrounding the Execution of the Lease-Option Agreement.

Appellants' entire argument that the trial court erred in receiving parol evidence concerning the circumstances surrounding the execution of the lease-option agreement is based upon the faulty premise that the Court was entitled to look *only* at the dates of July 15 to August 15, 1964 in determining when the option to purchase could be exercised, and was not permitted to consider other provisions of the lease-option agreement, or any other circumstances, in determining this question.

To accept appellants' premise, it would be necessary to set aside the stipulation of the parties that the lease and option agreement constitute one single, entire agreement between the parties. We would have to ignore the provisions of the lease which clearly call for a term of sixty months and require payment of sixty monthly rentals of $7,747.00 each to be made by Interpublic. It would be necessary to accept the fallacious argument that the option portion of the agreement can properly modify the lease portion (*i.e.*, the term of the lease is controlled by the time for exercise of the option), but the lease cannot properly modify the option (*i.e.*, the time for exercise of the option is not controlled by the sixty-month term of the lease). The necessary result of adopting appellants' argument would be to defeat and frustrate the plain intention and expectation of the parties when they entered into their lease-option agreement, to deprive On Mark of the rentals to which it was en-

titled, to reward Interpublic with a "windfall" for its admitted breach of the contract, and to violate the most elementary rules of fairness and common sense.

In determining whether Interpublic was entitled under the lease-option agreement to exercise the option portion of that contract during the period July 15 to August 15, 1964, the trial court was not only permitted but was compelled to look at more than a few dates set forth in the option part of the agreement. It had to look at the entire lease-option agreement, including the provisions that:

a. The lease term was for a period of sixty months beginning on the date of delivery.

b. The lessee obligated itself to pay On Mark sixty monthly rental payments of $7,747.00 each.

c. If the plane suffered damage and was repaired, the lease term was to be extended so that the lessee's possession thereof "shall cover sixty full months."

Further, the Court had before it the uncontradicted evidence (which was admissible without regard to the "parol evidence" rule) that:

d. The A-26 aircraft was originally scheduled for delivery in October, 1959, but actual delivery to Interpublic was delayed by Interpublic's own acts and other causes beyond the control of On Mark until mid-December, 1959.

e. While in the possession of Interpublic, the aircraft was damaged on June 28, 1962. It required eight months to make and complete repairs to the plane, during which period payment of the lease rentals was suspended, and under the terms of the

lease the term of the lease was extended for an equivalent period.

f. Interpublic had sought to terminate the lease in February, 1963, on grounds found by the trial court to be spurious and without merit. When it attempted to exercise the option, it was in arrears in its rental payments to On Mark to the extent of sixteen months, or $123,952.00.

Considering all of these matters, it was perfectly apparent to the Court that there was an ambiguity, an inconsistency, and an uncertainty within the lease-option agreement with reference, among other things, to the time at, or within, which Interpublic had the right to exercise the option to purchase, and the total amount to be paid by Interpublic under the lease-option agreement. Accordingly, the District Court properly permitted the introduction of evidence of the circumstances under which the lease-option agreement was executed.

The evidence (which is set forth in some detail above in this brief) established clearly that the parties from the very beginning contemplated that On Mark's costs in remanufacturing the A-26 aircraft to Interpublic's specifications would be repaid by appellants through either an outright purchase by Interpublic or a lease arrangement; that, for tax considerations, Interpublic requested that the transaction take the form of a lease-option arrangement and be written in two separate documents each of which, in order to accomplish Interpublic's objective, would naturally not refer to the other; that the form of the transaction was immaterial to On Mark so long as it was rewarded financially in the same manner as a sale; that no one paid any attention

to the "option" price for the aircraft except only that such sum, when added to sixty payments of $7,747.00 each, would return to On Mark its out-of-pocket expense of $385,000, plus the interest which it was paying to the bank on its loan to finance the work; and that the specific amounts for rental and the option price used by the parties were determined by a formula furnished to On Mark by a leasing company on the basis of a purchase price or cost basis of $385,000.

The Court considered the fact that under the original delivery schedule of October, 1959, with the last three months' rentals paid in advance, the sixtieth monthly rental would have been paid by Interpublic in July, 1964, the period specified for exercise of the option. At that time if Interpublic had complied with the other terms of the option-lease agreement and had made all payments of rent, it would have made On Mark "whole" by a last payment under the option agreement of $32,-950 and Interpublic would, thus, be the owner of the aircraft.

The District Court properly found, on overwhelming and mainly uncontradicted evidence, that under the lease-option agreement and the circumstances under which that contract was made, Interpublic had no right to exercise the option to purchase the A-26 aircraft, except during the period between January 26, 1965 and February 26, 1965 (the fifty-seventh month of the lease term as extended); and that as a condition to the exercise of the option, Interpublic was required to have paid On Mark sixty monthly rentals of $7,747.00 each, or a total of $464,820.00. Accordingly, the trial court found that Interpublic's purported exercise of the option in July, 1964 was ineffective and that On Mark was

not obligated to sell the aircraft at that time for the option price of $32,950.00. [Find. 30; Clk. Tr. p. 171]

In arguing that extrinsic evidence was inadmissible, appellants focus *solely* on several words in the option portion of the agreement, claim that these words are clear and unambiguous, ignore completely the inconsistent provisions of the lease, and conclude that parol evidence was, therefore, inadmissible to "vary" the terms of the option portion of the integrated lease-option agreement.

The only authority presented by appellants to support their position is some general language in the cases that, in the absence of ambiguity, evidence concerning negotiations leading to a contract is not admissible to vary the terms of a written agreement; and they argue that there is not necessarily any ambiguity in language which permits the lessee to exercise an option to purchase property at a time prior to the end of the lease term.

The difficulty with appellants' argument is that there is a basic ambiguity, uncertainty, and inconsistency between the language in the lease and the option agreement which not only permitted but required an explanation. How could Interpublic be permitted under the option to purchase the aircraft after making only thirty-four monthly payments when the lease portion of the lease-option agreement required the lessee to pay sixty monthly payments? How can the lease term be terminated by the exercise of an option in July, 1964, when under the provisions of the lease the term of the lease had been extended until long after that date? If appellants do not concede that these questions require an explanation, they are either extremely naive or they deliberately ignore economic reality.

In the interpretation of contracts, a court is not restricted to an examination of only one portion of a written agreement, even though it is clear and explicit, but must consider and examine the entire agreement. This principle is established in Section 1641, *California Civil Code:*

> "The whole of a contract is to be taken together, so as to give effect to every part, if practicable, each clause helping to interpret the other."

When there is more than one contract relating to the same matter, between the same parties, and made as parts of substantially one transaction, they are to be taken and construed together. *Cal. Civ. Code*, Section 1642. *Collins v. Home Savings & Loan Association,* 205 Cal. App. 2d 86 (1962).

An ambiguity, calling for construction and permitting introduction of parol evidence, may arise as well from words plain in themselves but uncertain when applied to the subject matter of the contract. *Collins v. Home Savings & Loan Association, supra.*

When, taken together, two contemporaneous documents are internally inconsistent, parol evidence is properly admissible for purposes of showing the surrounding circumstances and to determine the meaning of the contractual provisions. *Mayers v. Loews, Inc.,* 35 Cal. 2d 822 (1950).

The paramount rule in the construction of contracts is that the court ascertain the intention of the parties. *Cal. Civ. Code,* Section 1636. In *Universal Sales Corp. v. California Press Mfg. Company,* 20 Cal. 2d 751 (1942), the court elaborated on this general rule, 20 Cal. 2d at 761:

> "As an aid in discovering the all-important element of intent of the parties to the contract, the trial court may look to the circumstances surrounding the making of the agreement [cases cited], including the object, nature and subject matter of the writing [cases cited], and the preliminary negotiations between the parties [cases cited], and thus place itself in the same situation in which the parties found themselves at the time of contracting."

The California courts, especially in recent decisions, have refused to permit the "parol evidence rule" to be used to prevent the ascertainment of the real intention of the parties to a contract. *Laux v. Freed,* 53 Cal. 2d 512 (1960); *Parsons v. Bristol Development Co.,* 62 Cal. 2d 861 (1965); *Bartel v. Associated Dental Supply Co.,* 114 Cal. App. 2d 750 (1952); *Collins v. Home Savings & Loan Association,* 205 Cal. App. 2d 86 (1962); *Louis Lesser Enterprises, Ltd. v. Roeder,* 209 Cal. App. 2d 401 (1962).

The policy of California courts liberally to consider extrinsic evidence in interpreting contracts is well-illustrated in the case of *Bartel v. Associated Dental Supply Co., supra.* There a lease gave the lessee the right to cancel, after a certain date, "upon six months' written notice or at its option [Lessee] shall become entitled to a reduction of rent . . . in the event that the business of Lessee has declined to a degree that it would be impossible to pay the rent herein provided, due to" certain specified causes. Plaintiff claimed that parol evidence was admissible to show that the parties intended that the right of lessee to *either* cancel or obtain a reduction in rent was conditional; defendant claimed the lease

gave him the right to cancel with or without cause. In upholding the trial court's consideration of extrinsic evidence, the court set forth these well-established principles to be applied with reference to the admission of parol evidence (114 Cal. App. 2d 752):

> "Unless a court can 'to a certainty and with sureness, by a mere reading of the document, determine which is the correct interpretation . . . extrinsic evidence becomes admissible as an aid to interpretation . . .' (*MacIntyre v. Angel,* 109 Cal. App. 2d 425, 429 [240 P.2d 1047].)"

The opinion stated that the courts in applying the parol evidence rule were showing less rigidity than formerly and that (114 Cal. App. 2d 753):

> 'As well said by Mr. Justice Dooling in *Body-Steffner Co. v. Flotill Products, Inc.,* 63 Cal. App. 2d 555, 561-562 [147 P.2d 84], '. . . where extrinsic evidence is offered to explain inconsistent provisions in a contract courts should not strain to find a clear meaning in an ambiguous document, and having done so exclude the extrinsic evidence on the ground that as so construed no ambiguity exists . . .' Mr. Presiding Justice Peters said in *Wells v. Wells,* 74 Cal. App. 2d 449 [169 P.2d 23]: 'Much can be said in support of the rule that parol evidence is not only admissible to explain an ambiguity appearing on the face of the document but is also admissible to show that what appears to be a perfectly clear agreement, in fact meant something entirely different to the parties.' (See, also, *Jegen v. Berger,* 77 Cal. App. 2d 1, 7 [174 P.2d 489].)"

Finally, the court pointed out that (114 Cal. App. 2d 753):

> "In *Barham v. Barham*, 33 Cal.2d 416 [202 P. 2d 289], Mr. Justice Spence succinctly sums up the rules concerning the interpretation of agreements (pp. 422-423): 'When the language used is fairly susceptible to one of two constructions, extrinsic evidence may be considered, not to vary or modify the terms of the agreement but to aid the court in ascertaining the true intent of the parties [citation], not to show that "the parties meant something other *than* what they said" but to show "what they meant *by* what they said" [citation]. Where any doubt exists as to the purport of the parties' dealings as expressed in the wording of their contract, the court may look to the circumstances surrounding its execution — including the object, nature and subject matter of the agreement [citation] — as well as to subsequent acts or declarations of the parties "shedding light upon the question of their mutual intention at the time of contract" [citation].'"

The approach of the California Supreme Court to the "parol evidence" rule is shown in the recent case of *Parsons v. Bristol Development Co.*, 62 Cal. 2d 861 (1965), dealing with a landowner's liability for the balance of a fee under an architect's contract. The court, without any discussion of whether or not the particular provision was or was not ambiguous, or whether it was being "varied" or merely "explained," held (62 Cal. 2d 864-865):

> "The trial court properly admitted evidence extrinsic to the written instrument to determine the

circumstances under which the parties contracted and the purpose of the contract. (Code Civ. Proc., §1860; Civ. Code, §1647; see Corbin, *The Interpretation of Words and the Parol Evidence Rule,* 50 Cornell L.Q. 161)."

In *People v. Ganahl Lumber Co.,* 10 Cal. 2d 501 (1938), the California Supreme Court was presented with a case remarkably similar to the one at bar. Southern Pacific Railroad Company had leased a parcel of land to Ganahl upon which the latter had built and operated a lumber yard. The railroad had also built a spur track to the leased parcel, the cost of which, however, was paid by Ganahl. These transactions were dealt with in separate documents, a lease agreement and a spur track agreement, which bore different dates, but which had been delivered on the same date, and which the court held should be construed as a single instrument.

The lease agreement expressly provided for an initial term of one year, and a month to month tenancy thereafter. The spur track agreement provided that Ganahl would receive, in semi-annual payments, a rebate of $2 for each carload of freight shipped over the spur until a sufficient number of cars had been shipped that the sum of $1,016.21, representing the cost of a specified segment of the spur track, had been recovered by Ganahl.

In April of 1934, the state commenced an action to condemn for highway purposes a portion of the leased parcel. Southern Pacific, apparently with advance knowledge of the impending condemnation, had on January 22, 1934, served upon Ganahl notice of termination of its lease. Ganahl refused to quit the premises.

In the condemnation action the trial court admitted parol evidence that the intent of the parties was that the term of Ganahl's lease was to run at least until Ganahl had regained the sum of $1,016.21 in rebates. Based upon the amount of rebates during the nine years that had passed, this meant that the term of the lease would be at least thirty-two years. The trial court found, therefore, that the term of Ganahl's lease had twenty-two years and eleven months to run in April of 1934 and awarded Ganahl damages for the condemnation of its leasehold. The state appealed this award to the California Supreme Court.

The same arguments that appellants here make in their brief appear to have been made in the *Ganahl* case. It was claimed that there was no ambiguity concerning the term of the lease for the agreement stated perfectly clearly that the tenancy was from month to month. It was claimed that there was no unavoidable conflict between this provision and the rebate provisions for the spur agreement did not affirmatively obligate Southern Pacific to pay the full $1,016.21 to Ganahl, since it could be read to mean only that Ganahl would receive $2 per car up to a maximum of $1,016.21.

Despite the surface plausibility of such contentions, the California Supreme Court in *Ganahl* held that the provisions were inconsistent and produced "ambiguity that justified the trial court in admitting evidence to explain the real meaning and intention of the parties in the execution of the two instruments." The court affirmed the trial court's holding that the lease had twenty-two years and eleven months to run, even though the lease expressly provided that the tenancy was from month to month.

Thus, even though a contract provision is perfectly clear and plain, parol evidence is admissible if such provision is possibly at odds with the over-all intent of the parties as expressed in the remainder of the agreements and the circumstances surrounding the making of the contract. The fact, therefore, that the phrase "between July 15, 1964 and August 15, 1964" is clear and unambiguous, does not preclude the admission of extrinsic evidence of the purpose and true nature of the contract, and the intention of the parties.

Another well established principle in the interpretation of contracts is the following taken from *Stoddart v. Golden*, 179 Cal. 663, 665 (1919):

> "A principle of construction well settled is that where one construction would make a contract unusual and extraordinary, and another construction, equally consistent with the language employed, would make it reasonable, fair, and just, the latter construction must prevail."

Interpublic's construction of the contract is not only unreasonable, unfair and unjust, but it is utterly absurd. If its interpretation is accepted then, contrary to the lease provisions, the term of the lease (and the time for exercising the option) would not be extended by the periods required to repair the plane after an accident. The result would be that the *more* accidents and damage it caused to the plane, and the more expense it caused On Mark, the *less* Interpublic would have to pay to acquire ownership of the aircraft! Such a result must be dismissed as fantasy.

Mayers v. Locw's, Inc., 35 Cal. 2d 822 (1950), considered a factual situation somewhat analogous to that

in the instant case. A collective bargaining agreement provided for increases in wages for certain classifications of employees, including those on the "graveyard" shift, changed the time for commencing the "graveyard" shift to a different hour, and made such increases retroactive to a date seven months prior to the execution of the agreement. A letter between the company and the union, executed and delivered similtaneously with the collective bargaining agreement, provided that the change in time of the "graveyard" shift did not commence until a date which was more than a year after the retroactive date of the wage increases. Plaintiff union members sued under the formal contract for the retroactive wage increase. Defendant claimed that the plaintiffs were not entitled under the letter agreement to receive the retroactive wage increase. The trial court excluded evidence concerning the letter agreement on the ground that it would modify and contradict the formal agreement.

The California Supreme Court (*per* Justice Traynor) reversed the judgment. In its opinion the court held that extrinsic evidence was admissible because the formal contract and the letter agreement had to be construed together and, when so construed, the documents were ambiguous and inconsistent, for their terms furnished no clear answer to whether the parties meant that payment of retroactive compensation should be governed by the date set forth in the collective bargaining agreement or in the letter agreement. In its opinion the court stated (35 Cal. 2d 829):

> "It is thus apparent that the contract is not clear on its face, and under the theory of the parol evidence rule that has been accepted by the majority

> of this court, evidence of the negotiations of the parties and of surrounding circumstances was admissible for the purpose of determining the meaning of the contractual provisions. (*Universal Sales Corp. v. California Press Mfg. Co.,* 20 Cal.2d 751, 761-762 [128 P.2d 665]; *California Canning Peach Growers v. Williams,* 11 Cal.2d 221, 228-229 [78 P.2d 1154]; *Merkeley v. Fisk,* 179 Cal. 748, 757 [178 P. 945]; see *Union Oil Co. v. Union Sugar Co.,* 31 Cal.2d 300, 306, 307 [188 P.2d 470]; *Body-Steffner Co. v. Flotill Products,* 63 Cal. App. 2d 555, 561-562 [147 P.2d 84]; *Torrey v. Shea,* 29 Cal. App. 313, 316-317 [155 P. 820]; Code Civ. Proc., § 1860; Civ. Code, § 1647.)"

In the case at bar the lease and option agreement must be construed together for they constitute a single contract. When so construed, it is not at all clear whether Interpublic is entitled to exercise the option during the period July 15 to August 15, 1964, if on that date it has not paid sixty months' rent. Nor is it clear that even if Interpublic is entitled to exercise the option at that time, it is not required to pay additional monthly rentals during the balance of the extended sixty months' term. Accordingly, extrinsic evidence was admissible to determine the meaning of the contractual provisions.

Appellants contend that a lease can contain a provision giving the lessee an option to purchase the property prior to the end of the term; and that the exercise of the option extinguishes the lease and any further obligation to pay rent (App. Op. Br. p. 14). Appellants argue that this principle fits the facts of this case; that therefore there can be no ambiguity or uncer-

tainty in this lease-option agreement; and, accordingly, parol evidence was inadmissible.

Appellants' argument begs the question because it *assumes* that our lease-option agreement clearly gave to Interpublic the right to exercise the option before the end of the lease term and prior to payment of sixty months' rent. But, as we have shown above in this brief, the lease portion of the agreement required payment to On Mark of sixty monthly rentals and the term had been extended after the plane accident "so that the Lessee's possession of said aircraft shall cover sixty full months."

Appellants' argument also *assumes* that Interpublic was not in default under the lease-option agreement when it purported to exercise the option in July, 1964. But this assumption, too, is erroneous and even appellants now admit their defaults.

Appellants cite, at pages 15 and 16 of their Opening Brief, three cases which are supposed to support their position on this issue: *Sacks v. Hayes*, 146 Cal. App. 2d Supp. 885 (1956); *Peebler v. Seawell*, 122 Cal. App. 2d 503 (1954); and *Murfee v. Porter*, 96 Cal. App. 2d 9 (1950). It is submitted that none of these cases sustains appellants' contentions and none is contrary to the determination reached below in our case.

The *Sacks* case does not involve the issue of admissibility of parol evidence. It involves a written lease-option agreement which called for a rental of $125.00 per month with an option to purchase the property for $13,500. There was no provision in the agreement for any specified number of monthly rentals and the option could be exercised at any time. The lessee was not in

default when she exercised the option to purchase. It is apparent, too, from the facts recited in the case that $125.00 per month represented a fair rental value for the premises and that $13,500 was a fair purchase price.

In our case, of course, the lease-option agreement required sixty monthly rentals to be paid to On Mark, and the lessee had long been in default in its payment of rentals when it purported to exercise the option. The evidence also shows clearly that the parties here had agreed that the option would be exercised at the end of the lease term. Finally, unlike *Sacks,* the option price in the case at bar bore no relationship at all to the value of the property, but was merely a nominal sum which, when added to the required sixty monthly rentals, would equal a predetermined purchase or acquisition cost for the aircraft.

Peebler v. Seawell, 122 Cal. App. 2d 503 (1954), cited by appellants did not involve the issue of admissibility of parol evidence. There the lessee was given an option to purchase the property at the end of the lease term at a price to be negotiated by the lessee and lessor. The lessee purported to exercise the option but the parties could not agree on the price and an arbitrator determined the figure, which was obviously its then market value. The lessee failed to make a down payment of one-third of the purchase price, as provided by the option agreement. The court held, therefore, that the lessee had failed properly to exercise the option, the lessee-lessor relationship continued, and the lessee was

obliged to continue paying rent. There is nothing in this case which even remotely supports appellants' position here.

Nor does *Murfee v. Porter*, 96 Cal. App. 2d 9 (1950), involve any of the issues presented by this appeal. There the court merely held that when a lessee is given an option to purchase at the end of a specified period, the lessee has a reasonable time in which to tender payment when the agreement was silent as to the time of payment.

The other cases cited by appellants at pages 17-20 of their brief are illustrative only of decisions where the court has found that parol evidence was inadmissible because the language of the contracts in question was clear and unambiguous and the facts did not justify going into the circumstances surrounding the making of the agreements. We can present a list of cases ten times as long where the courts have permitted such extrinsic evidence. Such a catalogue of authorities is unnecessary, however, for the general principles applicable to the "parol evidence rule" have already been sufficiently spelled out above in this brief.

Appellants also argue that On Mark, in preparing the documents, could have proposed language to the effect that the option to purchase should not be exercisable on the stated date if for any reason a full sixty months' rent had not been paid. (App. Op. Br. p. 20) It will be remembered, however, that the purpose of the lease-option arrangement was to secure a tax benefit to

Interpublic [Rep. Tr. pp. 241-242], and that appellants themselves requested that the arrangement be set forth in two separate documents. [Rep. Tr. p. 397] To show on the face of the documents a connection between the option and lease agreements might have defeated the anticipated tax benefit; accordingly, it is probably true that appellants would have rejected the very suggestion which Interpublic now makes concerning qualifying language to the option provision.

Appellants' argument suggests a counter argument by appellees. *Appellants* could have insisted that the language of the lease be modified to make it clear that Interpublic's obligations to pay sixty months' rent would be ended if and when it exercised the option to purchase. *Appellants* could have insisted that the lease language be changed to make it clear that the exercise of the option would terminate the requirement of the lease that, after an accident, "the Lease Agreement shall be extended accordingly so that Lessee's possession of said aircraft shall cover sixty full months." [Pltf. Ex. 2] Appellants chose not to request such changes but, instead, signed documents containing language which is ambiguous, uncertain, and inconsistent concerning these matters. They should not now be heard to object to evidence which helped clarify the meaning of the lease-option agreement and which was entirely consistent with the contemplation and intention of the parties.

Appellees submit, therefore, that the trial court properly received parol evidence relating to the circumstances under which the lease-option agreement was executed and the negotiations preceding the execution of the contract.

II.

Irrespective of the Issue of Admissibility of Parol Evidence, Appellants Were Not Entitled to Exercise the Option Because They Were in Default of Their Obligations Under the Lease-Option Agreement.

As the parties have agreed through a formal stipulation, the lease and option agreements constitute a single, entire agreement. [Clk. Tr. pp. 126-135] This stipulation is in accord with the evidence of the circumstances leading to the execution of the documents reviewed above in this brief.

Read by itself, the option agreement contains no recital of any consideration. There was no evidence of any consideration for the option other than the execution of the lease. Accordingly, unless the option agreement is supported by the consideration found in the provisions of the lease, the option would be unenforceable and would create no right in appellants. *Spaulding v. Yovino-Young,* 30 Cal. 2d 138 (1947); *O'Connell v. Lampe,* 206 Cal. 282 (1929).

In *Gordon v. Dufresne,* 205 Cal. 512 (1928), involving a lease for two years at $25.00 per month and an option to purchase for $6000, the court stated (p. 514):

> "[I]t has been many times decided that such agreements are not severable but that, on the contrary, the lease and option form one document, the provisions of which are interdependent, and the covenant to pay rent or do any other acts supports the option as well as the right to occupy the premises."

The necessary reliance by appellants upon the provisions of the lease, for consideration to support the option, is fatal to their claim that they had the right to exercise the option in July, 1964. For, as the trial court found, appellants breached the lease by refusing to accept delivery of the A-26 aircraft after completion of repairs in February, 1963, and by failing to pay the rentals due to appellees thereafter. [Concl. of Law 9, Clk. Tr. pp. 174-175] There was due to On Mark on June 30, 1964, when Interpublic purported to exercise the option, sixteen past monthly rentals, aggregating $123,-952.00, plus interest and other expenses. Further, appellants had treated the lease as having been terminated since February, 1963 [Pltf. Ex. 72]. These matters are not challenged by appellants on this appeal.

It is settled law that the holder of an option to purchase property is not entitled to exercise such right when he is in default of his obligations to the owner of the property. This principle is beyond dispute and needs no citation of authority, but several analogous cases are discussed below.

In *Helbig v. Bonsness,* 277 N.W. 634 (Wis. 1938), the defendant had given to the plaintiff an option to purchase a farm prior to a specified date for $2,500. At the same time a lease was executed for one year, which the plaintiff subsequently breached by failing to pay rent. The plaintiff sought but was denied specific performance of the option, the court commenting as follows:

> "Under the transaction in question the plaintiff's obligation to pay the rent required under the lease constituted virtually the only true consideration for the option, as well as the lease, which, as

clearly part of one and the same transaction, should be construed and regarded as one agreement. [citations] Consequently the plaintiff's failure to pay any rent constituted such a complete failure of consideration for the option and the lease as to defeat his rights thereunder; . . ."

The court in *Helbig* also pointed out that in attempting to exercise an option, the lessee was seeking specific performance and had failed to satisfy the well-established equitable principle that "he who seeks equity must do equity."

In *Polish-American Volunteer, etc. v. Roman Catholic Church, etc.*, 139 Atl. 709 (N.J. Eq. 1927), the court denied specific performance of an option to purchase real property because the lessee-option holder had breached and forfeited the lease and "it necessarily follows, the continuance thereof and an abiding by its terms on the part of the complainant [was necessary to keep alive the option]" 139 Atl. 711 (Emphasis added).

The leading California case is *Mott v. Cline,* 200 Cal. 434 (1927). There the lease provided for a yearly rental of $250.00 to be paid on December 20th of each year; and contained an option provision whereby the lessee could purchase the premises at any time during the term for $4,100.00. The lessee had paid all yearly rentals due for some nine years when he gave notice of the exercise of his option on May 28, 1923. The rental for the year 1923 was not then due and would not become due until December 20, 1923. The court held in *Mott* that the lease was not entitled to exercise the option because he had failed to tender the rental for the four months' use of the premises during that year—although the rental was not yet due under the lease provisions.

Such failure to tender rent for the use of the premises was held to be "a complete bar and answer to his [lessee's] demand for specific performance of the option provision." (200 Cal. 450, 451).

The *Mott* case was followed in the more recent case of *Silveira v. Ohm,* 33 Cal. 2d 272 (1949), and states the prevailing rule in other jurisdictions where this question has been considered. See, for example, *Trotter v. Lewis,* 43 Atl. 2d 329 (Md. 1946).

California Civil Code, § 3392, codifies the decisional law by requiring one who seeks specific performance of a contract to have performed all conditions precedent thereto.

Appellees submit, therefore, that despite any other matter, the defaults and breaches by appellants of the lease-option agreement for sixteen months immediately prior to attempting to exercise the option constitute an absolute bar to appellants' claim.

The conduct of appellants in dealing with the option was typical of their utter disregard for the rights of On Mark and their continuous efforts to gain an unfair advantage. At the very time they attempted to exercise the option, appellants were maintaining—and had maintained for more than sixteen months—that the lease was terminated and they had no further obligations under it to On Mark. In the vernacular, appellants were really trying "to have their cake and eat it, too." They had breached and claimed a termination of one part of the integrated agreement (the lease) and yet sought to obtain the benefit of the other portion (the option). This, of course, they had no legal or moral right to do.

III.

The Court's Finding That the Parties' Intent Was That the Option Was Not Exercisable Until the Expiration of the Lease Term Is Fully Supported by the Overwhelming Evidence.

Appellants argue that there is no evidence to support the trial court's finding that the parties intended and agreed that before Interpublic was entitled to exercise the option, and as a condition thereto, it was required to pay a full sixty months' rent. (App. Op. Br. p. 21) Then appellants set forth a four-page summary of some of the evidence introduced at the trial, most of which evidence directly supports the trial court's finding. (App. Op. Br. pp. 21-25)

Appellees have discussed above in this brief some of the evidence received by the trial court concerning the parties' intention and agreement on this issue. Without repeating all of such matters, it is submitted that such evidence, including the following, fully supports the trial court's findings on this issue.

At the beginning of negotiations between the parties it was contemplated that Interpublic would "acquire" the A-26 aircraft for an acquisition or purchase price of between $385,000 and $400,000. The actual price of the plane was determined, according to Harder, by pricing each of the components specified by Interpublic to be included in the modified aircraft. [Rep. Tr. p. 897] From the component prices quoted to him by On Mark, Harder developed a "budget" around March, 1959 of $420,000 for the purchase of the plane by Interpublic. [Rep. Tr. pp. 899-900]

In April or May, 1959, Denny of On Mark quoted a sales price of $400,000 for the aircraft to Harder.

Harder claimed that his was too much money. The proposed sales price was then lowered to $385,000 by On Mark's reducing its "markups" on certain electronic and radio equipment to be incorporated into the aircraft. [Rep. Tr. p. 232] Harder agreed that this was a reasonable price and said he would recommend that the proposal be accepted by Interpublic. [Rep. Tr. p. 232]

Although the final form of the transaction was a lease-option agreement, the parties continued to talk in terms of a "cash purchase price" of $385,000 until almost the eve of execution of the lease-option documents. Harder, for example, testified that when he came to California in July, 1959, he brought with him and discussed with On Mark a "final indicated cash purchase price" of $385,000. [Rep. Tr. p. 925] Denny told Harder that On Mark would sell the plane to Interpublic for that figure. [Rep. Tr. p. 921]

The reason, of course, that the transaction finally was cast in terms of a lease-option agreement was Interpublic's desire not to make such an immediate cash outlay and its belief that a lease-option arrangement would be advantageous from a tax standpoint. [Rep. Tr. p. 240] On Mark was willing to proceed that way so long as it came out financially as well off as an outright sale. [Rep. Tr. pp. 241-242]

It is undisputed that the rental figure and the option price were established by a formula which was applied to a $385,000 proposed purchase price on a sixty-months' rental basis. [Rep. Tr. p. 251] The $7,747.00 monthly rental and the $32,950 option price, thus, were agreed upon only because upon completion of sixty months' rent and the payment of a final sum of $32,-950, On Mark would be in the same financial position as

if it had made an outright cash sale of the plane for $385,000.

The fact is that the total consideration of $497,770, which On Mark was to receive for sixty months' rental and the $32,950 option price, is within a few thousand dollars of the originally discussed purchase price of $385,000, plus interest thereon at 6% per year, amortized over a sixty-month period.

When Denny had received the $7,747.00 rental figure and the $32,950 option price from the leasing company, he met with Harder and told him that "On Mark would give [Interpublic] an option purchase price *at the end of the lease* when the sixty-months rentals had been paid, for $32,950." [Rep. Tr. p. 272] (Emphasis added). Harder agreed and said he would recommend its approval to Interpublic. [Rep. Tr. p. 273]

Harder, president of Interpublic, clearly disclosed his intention that the lease-option agreement required sixty rental payments before the option could be exercised. As set forth above in our Statement of the Case, he testified on several occasions that under the lease-option arrangement Interpublic must have the right to "recapture" or "receive" the aircraft "*at the end*" of the lease term. [Rep. Tr. pp. 802-803, 804] He also testified that when he received the lease rental and option price figures he made a computation which showed that the total rentals and the option price came to approximately half a million dollars. [Rep. Tr. p. 1416] He had no knowledge of how the $32,950 option price was determined [Rep. Tr. p. 1416], but he was interested only in what the total rental and option cost for the plane would be to Interpublic.

In the light of such undisputed evidence, it cannot be denied that the parties intended at all times that Interpublic would acquire the plane for a certain over-all price to be paid to On Mark. On Mark was thus to be reimbursed for the approximately $385,000 it was to spend to remanufacture the plane according to Interpublic's specifications, borrowing $375,000 at a minimum of 5% interest from the bank to finance its costs. [Rep. Tr. p. 264; SFB Ex. 1] It is equally clear that the option price of $32,950 was considered a "tag on" nominal consideration which had no relationship whatever to the expected value of the plane in July or August, 1964; it was merely the figure which, when added to sixty monthly rentals of $7,747.00, would equal the amortized cost, plus interest, over a five-year period of an aircraft having a predetermined cash value in July, 1959, of $385,000.

It is obvious, too, that the intention and contemplation of the parties, that On Mark would receive the predetermined over-all price during an extended term from Interpublic, would be defeated unless all of the sixty months rentals were paid to On Mark. That is why the lease required Interpublic to pay "sixty monthly rental payments" of $7,747.00 each, and why the lease provided for an extension of the terms in the event of an accident to the plane "so that Lessee's possession of said aircraft shall cover sixty full months." [Pltf. Ex. 2]

It is not true, as appellants claim, that the extrinsic evidence concerning the intention of the parties constituted "general statements made in preliminary discussions many weeks" before the execution of the lease option agreement. (App. Op. Br. p. 26) The statements of the witnesses were quite specific and, as pointed out

above, were made right down to a time just before the agreements were signed.

Appellants disagree with the trial court's finding that the dates July 15 to August 15, 1964, were put into the option agreement because the original delivery date for delivery of the aircraft to Interpublic was October 14, 1959; that since the last three months' rent were paid in advance there were then fifty-seven months beyond October 15, 1959 left of the sixty month term; and that fifty-seven months beyond October 15, 1959 would be July 15, 1964. [Find. 9(c); Clk. Tr. p. 163] Appellants claim that such a finding is "fallacious" because Denny "unequivocally stated" that at the time of the execution of the lease-option agreement in July, 1959, it was not contemplated that the plane would be delivered by mid-October. (App. Op. Br. p. 27) It is interesting to observe that, in making this argument, appellants rely upon a portion of the extrinsic evidence whose admission they claim was erroneous.

There are, however, several difficulties with appellants' argument. First, Denny did not "unequivocally" state that On Mark did not contemplate delivery of the plane in October, 1959. The testimony from Denny's deposition on this point quoted in appellants' brief is that *normally* it takes approximately five months to remanufacture and deliver this kind of an executive aircraft. (App. Op. Br. pp. 27-28) The normal time for delivery is not controlling over the specific date agreed upon by the parties. Denny testified at the trial that the October delivery date was "pretty tight" but he did not state that it was impossible to meet it. [Rep. Tr. p. 259]

Secondly, the court found that, *after* execution of the lease-option agreement, Interpublic requested changes

and additions to the specifications for the A-26 aircraft and that as a result thereof such delivery of the aircraft was delayed from mid-October, 1959, as originally anticipated by the parties, to December 18, 1959. This delay in delivery was found not to be the fault of On Mark. [Find. 10; Clk. Tr. p. 164]

Thirdly, even after the changes and additions to the specifications by Interpublic, the parties *again* expressed their intention to meet an October delivery date but agreed that On Mark would be excused from such obligation if delivery was delayed by reasons beyond its control. [Pltf. Ex. 4]

Respondents submit, therefore, that the finding of the trial court, that the parties intended that sixty months' rent be paid before the option was exercisable, is fully supported by the lease-option agreement and the evidence.

Appellants point out that the lease "included numerous conditions involving considerable expense for the lessee, such as the obligation to maintain the aircraft, to insure it, and to pay taxes levied against it." (App. Op. Br. p. 26)

The fact that Interpublic incurred the normal expenses of an owner (*e.g.* insurance, maintenance costs, ordinary repairs, taxes) as it operated the aircraft under the lease, is additional proof that the parties looked upon their arrangement as one in which appellants were, in effect, purchasing the aircraft for a predetermined price as they made payments under the lease. That predetermined price, as shown above, was broken down for Interpublic's convenience into sixty monthly payments and a final so-called "option price" of $32,950.

The parties never intended or contemplated that Interpublic would become the owner of the aircraft before the full price, including the sixty payments of rent, had been received by On Mark.

Appellants argue that no injustice is done if Interpublic is permitted to purchase the plane for the option price, without paying sixty months' rent after an accident and repairs to the aircraft. (App. Op. Br. p. 30) The argument will not stand analysis.

If a damaged aircraft is properly repaired, there is no necessary diminution in its value; and even if there might be, there is utterly no relationship between such diminished value and the option price of $32,950. Further, during the period of repair, Interpublic suffered no damage or expense, for its payments to On Mark were suspended. Its aircraft needs were fully met by the leasing from a third party of another aircraft at a rental less than it had paid to On Mark. [Find. 26; Clk. Tr. p. 170] On Mark, of course, lost eight months' rent, or $61,976.00 during the repair period which, if appellants have their way, would be denied to On Mark forever, despite the fact that the lease provides under these circumstances for an extension of the lease term for an additional eight months. If appellants do not really see in these matters any injustice to On Mark, they can hardly claim to have given us an impartial judgment.

Appellees submit, therefore, that the lease and option agreement, construed together, and the evidence concerning the circumstances surrounding the negotiation and execution of the agreement, overwhelmingly support the trial court's determination that the parties intended that the option was not exercisable until Interpublic had paid sixty monthly rentals.

IV.

Appellees Were Entitled to All of the Damages Awarded by the Trial Court.

Appellants' entire argument in this portion of their brief (App. Op. Br. pp. 31-42) is based upon their claim that they had the right to exercise the option to purchase the A-26 aircraft in July, 1964. Responsibility for rentals and maintenance costs beyond July 15, 1964, were cut off, appellants claim, because the trial court should have found that the option was exercisable on that date.

We have shown in the immediately preceding portion of this brief the errors in the premise upon which this claim of appellants is based and have demonstrated, we believe, that the trial court correctly determined that Interpublic had no right on July 15, 1964 to exercise the option to purchase the A-26 aircraft. Accordingly, we refer the Court to our earlier analysis of this issue and incorporate herein the citation of evidence and authorities, and the arguments and discussion, set forth therein.

Under the lease Interpublic was to have possession of the aircraft for a full sixty months and was obliged to pay sixty rentals of $7,747.00 each. Therefore, had Interpublic not breached the agreement, On Mark would have received the sum of $464,820.00 from Interpublic in rentals. In fact, however, Interpublic paid only sums aggregating $263,398.00, leaving a difference of $201,422.00. The trial court held, therefore, that On Mark was entitled to a judgment for $201,422.00, representing payments accruing under the lease from February 27, 1963 (the date when Interpublic should have taken redelivery of the aircraft after it was repaired) until April

26, 1965 (the end of the lease term as extended by the period of repairs). [Concl. of Law 15; Clk. Tr. p. 175]

On Mark was also awarded the sum of $10,891.90, representing the costs incurred by it to maintain and store the aircraft after Interpublic's wrongful refusal to accept redelivery of the plane [Concl. of Law 16; Clk. Tr. p. 176]. These costs would have been paid by Interpublic had it not defaulted under the lease, for it was obliged to "bear all maintenance costs with respect to said aircraft" under that agreement. [Find. 27; Clk. Tr. p. 170]

It is clear, therefore, that On Mark was awarded in the trial court's judgment not a penny more than it would have received had Interpublic not breached the lease-option agreement. There was, therefore, no violation of the principle which appellants cite, that damages for breach of contract may not exceed that to which the innocent party would have received by full performance of the agreement.

Appellants' argument that the exercise of the option extinguished their obligation to pay rent has already been answered above in this brief. The argument is apparently not taken too seriously even by appellants for they admit that in view of Interpublic's default, "On Mark did not have to deliver the airplane." (App. Op. Br. p. 35) This being so, it is difficult to see how there could be a "merger" of the lessee's and owner's interest in the aircraft, or how the obligation for future rentals was extinguished. Appellants, of course, never tendered or offered to pay the past due rentals aggregating $123,952.00 at the time they purported to exercise the option, or at any other time. Their admitted breach of the lease-option agreement continues to this day.

V.

Appellants Were Not Entitled to Offset the "Value of the Option" Against Rental Payments.

Appellants argue that the trial court erred by not giving Interpublic "credit" for the "value of the option" on July 15, 1964, when Interpublic purported to exercise its right to purchase the aircraft. They contend that the plane was then worth $125,000, that therefore the option to purchase at $32,950 was worth $92,050, and that the latter amount should have been offset against the damages awarded to On Mark. (App. Op. Br. pp. 37-42) The trial court considered this same argument of appellants and rejected it upon its findings that:

> (1) Interpublic had no right to exercise the option on July 15, 1964, since the lease-option term had been extended by the length of time required to repair the plane, that is, many months after July 15, 1964. [Find. 30; Clk. Tr. pp. 171-172]
>
> (2) Interpublic was not entitled to exercise the option on July 15, 1964 because it was then in default of the lease-option agreement. [Find. 30; Clk. Tr. pp. 171-172]
>
> (3) Interpublic was not entitled to exercise the option until it had paid sixty months' rent to On Mark. [Find. 30; Clk. Tr. pp. 171-172]

Appellants' further error lies in their ignoring the fact that an option is not a binding agreement to sell the subject matter of the option but merely an offer to sell on prescribed terms. *Glascock v. Sukumlyn,* 131 Cal. App. 2d 587 (1955). Unless the offer is accepted within the time limited and according to its terms, it is of no

force for any purpose. *Upton v. Travelers Insurance Co.,* 179 Cal. 727, 729 (1919).

On Mark's offer to sell the aircraft to Interpublic for $32,950 was rendered irrevocable, in other words an "option," only by the consideration of Interpublic's promises contained in the lease. On Mark would have been obligated to sell and Interpublic obligated to purchase the A-26 aircraft only if Interpublic accepted the offer according to its terms. This is basic contract law which needs no citation of authority. In this case, the terms of the offer included performance as promised under the lease, a promise which Interpublic now admits it did not keep. Therefore, Interpublic's attempt on July 15, 1964 to accept On Mark's offer to sell the aircraft was ineffective; no obligation to sell or purchase ever arose and the option was "of no force for any purpose."

A review of the facts demonstrates that On Mark is in no better position because of the judgment of the trial court than it would have been had the parties' agreements been fully carried out. On Mark fully performed each of its obligations under the lease. It remanufactured a war surplus plane into an executive aircraft at a cost of some $385,000. It also fully restored the aircraft to an airworthy condition. Thus, the following words of an authority quoted by appellants fully support On Mark's legal position herein: "If the party complaining has completely performed all the promises and conditions incumbent on him under the contract, then he recovers the full value of the benefits which he would have realized from the other's performance." *McCormick, Damages,* Section 143 (App. Op. Br. p. 39)

The trial court correctly awarded On Mark the full value of what would have accrued to it under the lease — the unpaid rentals and interest thereon. The fact that the option could not be properly exercised did not save On Mark from the expense of any performance, as appellants contend. As we have shown, On Mark never became obliged to sell the aircraft to Interpublic for $32,950 because of Interpublic's breach of its obligations. Under the agreement of the parties, at the end of the lease term as extended, and after paying all rentals as due, Interpublic could have returned possession of the plane to On Mark, and the transaction would have been closed. Certainly appellants do not contend that had this occurred they would have been entitled to a rebate or refund, representing the difference between the then value of the plane and the option price. It is incomprehensible how appellants can now claim a credit in a like amount after admittedly defaulting under the lease.

It is not quite accurate, as appellants contend, that after Interpublic's refusal to accept redelivery of the plane, On Mark "enjoyed full ownership" of the aircraft and used it freely for personal travel and in its business. (App. Op. Br. p. 38) The plane had to be flown to keep it in a good operating condition. [Find. 27; Clk. Tr. p. 170] It is not particularly relevant, then, that some of the flights by On Mark personnel were for business or personal reasons; in fact, many were test flights or flights in which the aircraft was demonstrated to potential buyers. [Pltf. Ex. 76; Rep. Tr. pp. 362-363]

Although appellants were not legally entitled to it, in order to "do equity," the trial court held that Interpublic could exercise the option to purchase the aircraft between August 10, 1965 and September 9, 1965 (*i.e.*, within a month's period after the filing of the Judgment herein), upon payment of the amounts found to be due to On Mark. [Concl. of Law 17; Clk. Tr. p. 176] Appellants, however, failed to take advantage of this offer and now claim that by granting to them this equitable consideration the trial court "wrote a new contract for the parties" and deprived them of the benefits of the option agreement as negotiated. (App. Op. Br. p. 38) This is simply not true.

Appellants negotiated only for the right to acquire title to the plane after paying sixty months' rental and the option price. Interpublic had no right to "exercise" the option while in default and then demand a "credit" against damages caused by its own contract breach. Upon complying with the lease provisions, Interpublic had a right under the "option" either to purchase the plane or to refuse to purchase it. But it certainly had no right to do neither and then demand a "credit" for the difference between the option price and the then value of the aircraft. To grant appellants the right they now claim would, indeed, be rewriting the agreement between the parties in a manner clearly contrary to their intentions and to settled principles of law.

VI.

The Judgment in Favor of Appellee Security First National Bank Is Correct and Should Be Affirmed.

To secure a loan from Security First National Bank ("Security Bank") for $375,000 to finance the cost of remanufacturing the A-26 aircraft, On Mark assigned to the bank all rentals due under the lease with Interpublic. [Pltf. Ex. 9.] These rentals were paid directly by Interpublic to the bank until June, 1962. Thereafter, On Mark made additional payments of principal and interest directly to Security Bank, but at the time of the trial herein the principal sum of $118,857.10 was still due to the bank plus interest at the rate of 5% per annum from November, 1964. [Find. 31; Clk. Tr. p. 172.]

Interpublic consented in writing to the assignment and payment of the lease rentals to the bank and agreed in its "Receipt and Consent to Assignment" that Interpublic would not terminate or consent to the termination of the lease without the written consent of the bank. [Pltf. Ex. 9]

Of the sum of $201,422.00 awarded as damages to On Mark, the trial court directed that said amount of $118.857.10 be paid by appellants directly to Security Bank, leaving a balance of $82,564.90, plus interest, to be paid to On Mark under the judgment. [Concl. of Law 15; Clk. Tr. p. 175; Judgment, Clk. Tr. pp. 182-184]

Appellants contend that the portion of the judgment in favor of Security Bank is erroneous because it includes rentals that accrued after the exercise of the option. We have already shown, as the trial court found, that appellants could not and did not effectively exer-

cise the option, and that the rentals would continue to accrue until sixty monthly payments had been paid by Interpublic. Accordingly, the judgment in favor of Security Bank is fully supported by the evidence and the law and should be affirmed on this appeal.

Appellants next argue that there was no valid consideration to support an independent obligation that appellants would not terminate the lease without the consent of the bank prior to payment of all rentals due under the lease. In making this contention, appellants attack the trial court's findings that Interpublic reasonably could have expected that in reliance upon its consent to the assignment and its promise not to terminate the lease, the bank would act to its detriment; that the bank, in fact, did so act when it released one of the personal guarantors of the promissory note secured by such assignment of the lease; that such release of the guarantor was a detriment suffered by the bank and constituted a legal consideration for Interpublic's agreement not to terminate the lease; and that Interpublic was estopped to deny that it would not terminate the lease without the consent of the bank. [Finds. 34, 35, Clk. Tr. pp. 172-173; Concl. of Law 11, 12, Clk. Tr. p. 175]

The evidence showed that the general substance of the financing arrangements for remanufacturing the A-26 aircraft was communicated by Denny of On Mark to Interpublic's Harder; that the assignment was executed by Denny and mailed to Interpublic; and that only after execution of the "Receipt and Consent to Assignment" by Interpublic, and its return to the bank, did the bank release Mr. Doheny from his personal guarantee. [Rep. Tr. pp. 1057-1059; SFB Exs. 7, 8, 9]

Appellants argue that since Interpublic was never given actual notice of Security Bank's release of the third party guarantor, such release cannot be effective as consideration to make the consent to assignment a binding agreement. (App. Op. Br. p. 47) This contention ignores the doctrine of promissory estoppel and the fact that such an estoppel can be effective even without specific knowledge or notice on the part of the promissor.

Clearly applicable is Section 90 of the Restatement of Contracts, which states:

> "A promise which the promisor should reasonably expect to induce action or forebearance of a definite and substantial character on the part of the promisee and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise."

As pointed out by the California Supreme Court in *Drennan v. Star Paving Co.*, 51 Cal. 2d 409 (1958):

> "The very purpose of section 90 is to make a promise binding even though there was no consideration 'in the sense of something that is bargained for and given in exchange.'" (51 Cal. 2d at 414).

These principles are squarely applicable to the instant case. Here appellants have made a promise which constitutes such a substantial part of the entire loan transaction that there can be no question that appellants reasonably expected that their promise not to terminate or modify the lease agreement would induce reliance on the part of Security Bank. This is particularly true because if the bank had relied solely upon the assign-

ment of rents, the *consent* of appellants would not have been needed. But, where the bank sought and received an agreement not to terminate or modify the lease, it is obvious that it had every expectation of relying upon this very covenant. The trial court so found. [Find. 35; Clk. Tr. p. 173]

In this connection, it is significant to note that there is no provision in Section 90 of the Restatement of Contracts which requires that the party relying communicate to the promisor that there will be reliance, or the nature or type of reliance. Nor is there any requirement that the promisor have such knowledge.

Although there are no California decisions dealing squarely with the issue of whether an essential element of promissory estoppel is specific knowledge by the promisor of the nature of the promisee's reliance, there is at least one very recent decision applying the doctrine where it is clear that the promisor had no knowledge of the nature of reliance which his promise induced. Thus, in *Greene v. Wilson*, 208 Cal. App. 2d 852 (1962), the trial court found as follows:

> "The plaintiff Greene knew that Doris Wilson, her attorneys and the persons who later lent money to her would rely on those statements and representations. In reliance thereon, she and her attorneys made no attempt to protect her from that liability in the final judgment of divorce, and persons to whom the statements and representations were made 'advanced money to and guaranteed loans to Doris Wilson in excess of $60,000.00.' In reliance on such statements and representations of the plaintiff Greene, Doris Wilson 'purchased thousands of dollars of new equipment for Tri-

> Color Laboratories and made representations of her own financial condition to equipment sellers and trade creditors,' on which representations such creditors relied. In reliance on the plaintiffs' statements and representations, Doris Wilson represented to the subsequent purchasers of the business that Mr. Greene had no claims against the business and the purchasers relied on such representations." (208 Cal. App. 2d at 855).

In *Greene* a creditor of defendant Doris Wilson's husband had promised that he would never assert any claim against her or any property she might acquire in a prior divorce action. The recitation of facts and the findings of the trial court show that there was no communication to the promisor of the nature of the promisee's reliance, and further that the promisor did not know of the nature of the promisee's reliance. Yet, Section 90 of the Restatement was applied and a promissory estoppel was established.

Greene directly supports the position of appellee bank herein that, in order to be bound by its promise to the bank, it was not necessary that Interpublic have knowledge that the precise type of reliance its promise induced would be the release of the third party guarantor.

Appellants claim that the striking from the "Receipt and Consent to Assignment" of certain words, to the effect that Interpublic gave its consent in order to induce the bank to make the loan to On Mark, proves that the bank could not thereby have been induced to release the guarantor. But this fact proves no such thing. Interpublic apparently was not willing to agree that its

consent was the inducement to the making of the loan to On Mark, probably because the loan then had already been made. But Interpublic was willing to, and it did, promise the bank not to terminate the lease. Given such a promise, it is not at all unreasonable to expect that the bank would rely upon it. This is exactly what Security Bank did when it released the guarantor. The trial court properly found that under these circumstances Interpublic should reasonably have expected that the bank would act to its detriment in reliance upon Interpublic's consent and agreement.

Appellants have cited *Williams v. Hasshagen*, 166 Cal. 386 (1913) and *Simmons v. California Institute of Technology*, 34 Cal. 2d 264 (1949) for the proposition that conventional consideration for a promise must be an act or a return promise bargained for and given in exchange for the promise.

The proposition is, of course, correct. However, it has no application to the instant case for the simple reason that appellee bank does not contend that consideration for execution of the "Receipt and Consent to Assignment" was present in the conventional sense. To the contrary, as the bank has urged, and as the trial court found, Section 90 of the Restatement of Contracts is applicable to make appellants' promises enforceable.

Appellants attempt to avoid the trial court's finding of promissory estoppel by arguing that facts were present which could have led the trial court to a contrary result. (App. Op. Br. pp. 48, 49) The error of this argument is perhaps best illustrated by appellants' misplaced reliance on *Kelley v. Rouse*, 188 Cal. App. 2d 92 (1961). In that case the court held Section 90 of

the Restatement of Contracts inapplicable where the *trial court found:* (a) no reasonable reliance; and (b) no detrimental change of position. However, since the court below has found both reasonable reliance and detrimental change of position by Security First Bank, *Kelley v. Rouse* has no application to the case at bar.

Conclusion.

The trial court found on overwhelming evidence that appellants breached the lease-option agreement by refusing to accept redelivery of the A-26 aircraft and by refusing to make rental payments aggregating $201,422. Appellants do not here dispute that they breached the lease-option agreement or that they caused substantial damages to On Mark; but they attack the judgment below on the narrow ground of alleged error by the District Court's admitting evidence of the circumstances surrounding the parties' making of their agreement.

Appellants' argument that extrinsic evidence was inadmissible ignores all of the provisions of the lease-option agreement except the dates of July 15 to August 15, 1964, found in the option portion of that integrated agreement. Blind to all but these few words, appellants claim that they are not ambiguous or uncertain and, therefore, the trial court as a matter of law, had no right to hear or consider the circumstances in which the words were used. Appellants also claim that the extrinsic evidence does not support the trial court's determination that the option was not exercisable in July, 1964.

Appellees submit that the trial court had not only the right but the duty to consider the evidence presented by both sides on this issue.

The trial court properly found that the provisions of the lease, requiring payment of sixty months' rent and, in the event of an accident to the plane, extending the term so that the lessee would have possession of the aircraft for a full sixty months, were inconsistent with the July 15 to August 15 option period. At the very least, the matter was uncertain and ambiguous, permitting the consideration of extrinsic evidence.

The lease provisions, as well as the evidence of the circumstances surrounding the execution of the agreement and the intention of the parties, showed without any doubt that appellants had no right to exercise the option until they had paid sixty monthly rentals and until the end of the extended term of the lease. Neither of these events had occurred when Interpublic, then in default for more than sixteen months and owing more than $123,000 in rentals, purported to exercise the option. The trial court properly determined, therefore, that Interpublic had no right to exercise the option to purchase the aircraft in July, 1964.

All of the other claims of appellants fall with a determination that they were not entitled to exercise the option in July, 1964. Lease rentals accruing after that date, as well as the cost of maintenance and repair, were all due and owing from appellants to On Mark under the lease. Appellants had no right to offset against rentals due the "value of the option" for they were not entitled to exercise the option until all of the sixty monthly rentals had been paid; in any event, the lease-option agreement did not give appellants the right to receive any such "credit" or "offset".

Acceptance of appellants' arguments would result in a "windfall" of more than $180,000 to those who inten-

tionally breached their contract and have sought by every stratagem to avoid their solemn agreement. It would result in a loss to On Mark of a similar sum which was expended in manufacturing a plane for appellants' own account. Further, such a result would set aside a judgment which is fair and equitable, which is based on overwhelming evidence, and which is in accord with the decisional and statutory law of this State.

Appellees, therefore, urge the Court to affirm the judgment below.

Dated: July 12, 1966.

Respectfully submitted,

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Certificate.

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

IRA M. PRICE II